The Aftermath of the Lehman Brothers Collapse in Hong Kong:
The Saga, Regulatory Deficiencies, and Government Responses

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Abstract:

The paper examines the fallout of the Lehman Brothers collapse in Hong Kong. As an international financial hub in Asia, Hong Kong was profoundly affected by the collapse of this company. As a result, it impacted negatively on the public's confidence in the Hong Kong's banking sector. Furthermore, this event has exposed a number of regulatory deficiencies in Hong Kong. In response to this financial crisis, the Hong Kong government had made an unprecedented move to negotiate with local banks to refund the investors. In addition, the government has also sought public consultation on proposal to enhance the regulation of the sale of financial products. This paper argues that there needs to be amendments to the prevailing laws and the inclusions of legal rules to back up those proposed measures so that the disclosed information from the financial institution will not mislead the investors or misrepresent the products offered.

Keywords: Financial crisis, regulatory reforms, disclosure, misleading information, misrepresentation

1. Introduction

The recent collapse of Lehman Brothers and its subsidiaries around the globe has attracted unprecedented amount of public controversy, leaving a large number of investors in despair, many of which have lost their entire life-savings. For much of 2009, if you were living in Hong Kong you would have experienced frequent disruption to traffic in the financial districts at Central and Kowloon due to the daily

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street protests by thousands of aggrieved investors. The newspapers and radio were inundated with distressing stories. At the extreme, there had even been reports of investors committing suicide. Evidently, this matter is of paramount importance to the integrity of island city's financial system as well as the welfare of the residents of Hong Kong.

In response to this financial crisis, the Hong Kong government by virtue of the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) negotiated directly with the banks and financial institutions with limited success and mixed results. In addition, the SFC has drafted a proposal for public consultation endeavouring to rectify this regulatory shortfall by proposing a series of remedial measures to investors who suffered some great losses in so-called Minibond(s) investments.

Nevertheless, the reputation of Hong Kong as an international financial hub in Asia had suffered after tens of thousands of investors who lost a great deal of money in this event. This collapse also exposed many weaknesses in the regulating the sale of investment products and snowballed into a crisis of public confidence. This calls for urgent attention by the government to restore the island city's financial reputation. Moreover, the banking sector is one of the "four pillars" industries in Hong Kong and it is enshrined in Hong Kong's Basic Law. Article 109 of the Hong Kong Basic Law stipulates, '[T]he Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.'[4] Hence, the collapse of Lehman Brothers in Hong Kong has passes beyond a matter of economic importance and became a matter with constitutional significance.

This paper will explore both the regulatory deficiencies exposed as a result of the collapse of Lehman Brothers and the government reform efforts in Hong Kong. It is only through this route the article will proceed to highlight the problems and offer recommendations in law reform. The primary source consists of news articles in both English and Chinese, and reports from the financial regulators in Hong Kong.

[4] Basic Law of the Hong Kong Special Administrative Region

In conclusion, this article will attest to the fact that free market requires not only robust laws to safeguard the vulnerable consumers, but also an appropriate mechanism to prevent crisis like Lehman Brothers from repeating again. It is therefore suggested that 'fixing the problems' requires a thorough investigation and a careful government response to ensure the root cause of this crisis is correctly addressed. One of those causes might be the failure of prevailing laws in Hong Kong to redress the grievances of the aggrieved Minibond investors.

2. An Attempt to decipher what is a 'Minibond'

In Hong Kong, 'Minibonds' (MB) (also known as High Notes) are credit-linked notes (CLNs). By definition, these CLNs are structured debt instruments under which payments of interest, principal or both are bundled as investment products. These financial products often offers relative good fixed rate of returns. Many of these MBs sold in Hong Kong were financial products developed and sold at wholesale level by Asian subsidiaries of Lehman Brothers in the US to many local banks and investment companies (referred to as reference entities), like HSBC, Hutchison Whampoa, DBS Group Holdings Ltd., Swire Pacific Ltd., Sun Hung Kai Properties Ltd., Goldman Sachs Group Inc. and Morgan Stanley. Due to the reputation and good track records of these financial institutions, MBs were widely sold to the general public.

The MBs are actually secured on collateral and swap arrangements with another Lehman subsidiary guaranteed by Lehman Holdings in the US. Funds raised were used to purchase collateral that was AAA rated at the time of purchase.[5] However, what the investors might not appreciate is the complicity and risk associated with products is highly dependent on unsustainable economic 'bubble' in the US property markets.[6]

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[5] Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 33 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

[6] Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 33 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

Investors of MBs were exposed to the credit risks of the reference entities without directly holding the debt obligations of the reference entities and without involving any reference entity in the transaction.[7] Accordingly, '[i]n event of the early redemption of the Minibonds/Notes, the recourse of the investors will be limited to the proceeds of realisation of the collateral (net of costs and expenses) plus or minus a swap termination amount.'[8] Thus the associated risk can be high, especially to the ordinary investors who are not normally equipped with sufficient financial knowledge. However, MB offers payment of good interest and redemption payout at maturity.[9] As such, the product was designed for sophisticated investors seeking exposure to high-grade assets that provide steady high returns.

Nevertheless, the above attempt to explain what MBs are and the structure of such products has only been able to offer a limited insight to the highly complex investment product. For the layperson, things like 'swaps' and 'debt-equity hybrids' are terms that are almost incomprehensible, let alone to understand it. Therefore complexity of such an investment product should not be underscored. And with tens of thousands of elderly, retirees, and blue collar workers in Hong Kong investing in MBs, one could only speculate that their decisions to do so were either based on irrational judgements or faith in the viability of the US credit swaps markets. In fact, as revealed later in this events, many investors claimed that they were misled into believing MBs were some kind of term deposits (see subsequent paragraphs for details). In addition, from a regulatory perspective the challenge of regulating and keeping up with such complex financial instruments should not be underestimated.

3. The Minibond Saga in Hong Kong

In 2005, a Lehman Brothers subsidiary known as 'Pacific International Finance Limited' (PIF) started selling MBs in Hong Kong. MBs subsequently became a popular investment vehicle mainly because they receive higher yields than other term

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[7] http://www.info.gov.hk/hkma/chi/press/2008_f.htm. Note that the securitisation of the debt is not direct. They are made up of bundled collaterals under swap arrangements through 3rd parties.

[8] Hong Kong Monetary Authority, 'Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured products Connected to Lehman Group Companies', 16 <http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf> at 21st September 2009.

[9] Hong Kong Monetary Authority, 'Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured products Connected to Lehman Group Companies', 3 <http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf> at 20th September 2009.

deposit products. They were sold in Hong Kong through a total of 20 banks and 3 brokers.[10] Amongst the many distributors of MBs, the Bank of China (Hong Kong) became the biggest retailer, accounting for some 30-40% of the total sales.[11] According to statistics by the SFC, Lehman Brothers-related MB sales in Hong Kong reached approximately HK$12.7 billion by 2008. This is a significant figure representing one third of the structured note[12] market share in Hong Kong.[13]

On the 15th September 2008, the Leman Brothers Holdings Inc. filed for bankruptcy in the US under Chapter 11 of the United States Bankruptcy Code. [14] Several Lehman Brothers subsidiaries in Hong Kong were put into liquidation shortly afterwards.[15] This marked the end of the MBs' high returns and a beginning of the crisis to come.

On September 23, 2008, a week after Lehman Brothers declared bankruptcy, hundreds of Hong Kong investors gathered in front of Hong Kong Monetary Authority's building to protest. Many of the investors' stories were similar: they bought these financial products (MBs) when their term deposits matured, because the banks in Hong Kong promoted MBs as an alternative investment product, analogous to 'a high return term deposit'.

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10 Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 29 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

11 The total investment sold by BOCHK was between HKD$3.7 billion to HKD$5 billion.

12 A Structured note normally refers to the structured security. U.S. Securities and Exchange Commission (SEC) Rule 434 (regarding certain prospectus deliveries) defines structured securities as "securities whose cash flow characteristics depend upon one or more indices or that have embedded forwards or options or securities where an investor's investment return and the issuer's payment obligations are contingent on, or highly sensitive to, changes in the value of underlying assets, indices, interest rates or cash flows." In addition, the Pacific Stock Exchange defines structured products as "products that are derived from and/or based on a single security or securities, a basket of stocks, an index, a commodity, debt issuance and/or a foreign currency, among other things" and include "index and equity linked notes, term notes and units generally consisting of a contract to purchase equity and/or debt securities at a specific time."

13 According to SFC, minibond market in HK was about HKD$36 billion, in which, Lehman Bros related minibond was about HKD$12.7 billion.

14 Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 28 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

15 Hong Kong Monetary Authority, 'Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured products Connected to Lehman Group Companies', 7 <http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf> at 21st September 2009.

For example, the banks marketed the sale of MBs by the use of glossy posters and mini-flyers with promotional material that clearly specified: '[t]his product is designed for a term of 3 years. The interest rate is a fixed rate of 5.5%. Interest is paid every quarter. Seven blue chip banks are jointly offering this product…[i]f your application is successful, you will also take home for free: a 46 inch LCD TV, a high quality digital video camera with Sony hard disc, Panasonic digital camera, cash back and gift card…'.[16] Naturally such advertisement attracted lots of interest from the public. When the Lehman Brothers collapse, the local media was flooded with allegations that reputable local banks had preyed on vulnerable, elderly and ignorant members of the public to invest in MBs. Mr. Guangyu Chen a retiree told the local media that, '[I] have always trusted our Hong Kong banks. I grew up in Hong Kong. I thought Hong Kong is a major financial centre of the world. But this thinking had made me penniless!'[17] Consistently, the crux of these complaints was that customers' intention to invest in term deposits had been deflected by the banks towards investing in MBs.[18] In accordance with advice received from the banks, investors mistakenly believed they had lodged their money in a 'safe', 'high-yield', 3-year term deposit. Yet, many investors were elderly with limited education, and were unable to comprehend the complexities of MBs. They complained that bank staff never told them about the risk in investing in MBs, only articulating that the investment product was issued by a large international company with a good track record. In many events, even the name of Lehman Brothers was never mentioned.[19]

Typical of the complaints was the experience recounted by Mr You, a 65 year old married man who invested his lifesavings of HK$1.7million in MBs. Mr You recounted:

> I started to buy Lehman Bros minibonds from November 2006. My intention had been to put all my savings into term deposits for a safe return. However, bank staff introduced the minibond to me. They said this is very similar to a term deposit, but the interest rate is much higher, 6% interest rate in the first 6

[16] Tse, W. Y. (2009). The Banks' Responses to Their Minibond Allegation. Hong Kong Financial and Economic News. Hong Kong: 3.

[17] Ar, R. (2009). "After Lehman Brothers Scandel." Retrieved 12 Sept., 2009, from http://www.cenet.org.cn/article.asp?articleid=38386.

[18] H Wang, 'Minibond Crisis in Hong Kong: the Stories Behind', Nan Fang Weekend News, P3-4.

[19] Ibid.

> years and the risk is basically nothing. How could I understand all these financial products? I trusted the bank and put my savings of my entire life in it…[20]

On September 16, 2008, the bank notified Mr. You that he would probably recover nothing from his investment.

Another example, Yu Lia Chun is a retired orderly with only a sixth-grade education in HK. She said she thought her money was in a savings account. She did not know she had bought minibonds from Lehman brothers. When Lehman Brothers collapsed she lost her entire nest egg of HK$1.2 million. She said '[t]here is no way a person like me could understand any of this…' Sun Kwan a 58-year-old retired parks worker who bought MBs from the Bank of China (BOC). For several days, he stood outside the Hong Kong headquarters of the BOC along with Yu and 51 other protesters, banging a chipped red drum with a stick under the hot sun and rain with a sign around his neck, hand-lettered in Chinese characters, read: "The Bank of China is a hooker. Give me back my money earned with blood and sweat." Sun, who has a high school education, invested about HK$285,000 in MBs, sold to him by BOC Hong Kong, which paid about 4 percent interest a year. He said he thought he was putting his money into a certificate of deposit. Sun and Yu like many other elderly people did not understand the prospectus and was persuaded by bank staffs to invest in a safe high yield products in which they had no understanding of. [21]

Other investors complained they never received information from the banks about their investments in MBs post-Lehman Brothers collapse. Rather, they only heard about their fate from newspapers or friends. Those banks that did notify investors only indicated that were issues with the MB investment without giving detailed information. Thus, during the many (almost daily at one stage) protests, investors displayed signs saying 'Cheating Bank' and 'Dodgy Bank' on the streets of Hong

[20] Wang, L. (2009). "There Must Be A Way to Save Us - An Report of the Social Impact in Hong Kong on the Collapse of Lehman Bros." Retrieved 7 Sept., 2009, from http://www.hkreporter.com/talks/viewthread.php?tid=249320.

[21] Mark Pittman and Bob Ivry, 'London Suicide Connects Lehman Lesson Missed by Hong Kong Woman' Bloomberg News, 9 September 2009, < http://www.bloomberg.com/apps/news?pid=20601170&sid=aNFuVRL73wJc#> at 25 November 2009.

Kong.[22] Thus, if the banks did act in the manner reported by the media, it would certainly be against good conscience and natural justice. Against this background, this paper proceeds to explore what the government has done and the legal issues.

4. Responses from the Hong Kong Government

As noted earlier, there were huge daily public protests. The media was inundated with calls from grieved investors to call for the resignation of senior government officials and the Chief Executive of the HK government. In response, the Legislative Council invoke a rare power to launch a special committee to investigate the MB scandal. On October 22, 2008, a member of Hong Kong Legislative Council, Mr. Jianfeng Lin brought a motion to the Council suggesting five immediate steps to be taken to deal with the Lehman Brothers crisis:[23]

1. Create a special cross-sector working group to advise MB investors in Lehman Brothers and related products;
2. Complete the investigation into the MB scandal in a shortest possible time. If misconduct is found, to help investors to recover their investments;
3. Provide full support for investigations to be initiated by the HK Consumer Council. If it is necessary, help small investors by funding their legal actions via the Council special litigation grant;
4. Ensure that the government contact the banks and financial institutions on the behalf of small personal investors to negotiate a settlement;
5. That the SFC and HKMA undertake comprehensive investigation as to whether there were oversights in their own organisations in relation to the handling of MB and related products.

In an unusual sign of unity, the Legislative Council overwhelmingly supported this motion with a few minor amendments.[24] The fact that the Legislative Council responded so swiftly to this case, within one month after the collapse of Lehman Brothers, demonstrated the scale and depth of this problem.

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22 http://www.china.com.cn/economic/txt/2009-07/15/content_18138305.htm

23 http://www.legco.gov.hk/yr08-09/chinese/counmtg/motion/mot_0809.htm#081022

24 http://www.legco.gov.hk/yr08-09/chinese/counmtg/motion/mot_0809.htm#081022

Furthermore, in response to the unprecedented public fallout of the Lehman Brothers scandal, the Hong Kong government set up a complaint procedure for investors of MBs and related products. They were asked to lodge a formal complaint with the HKMA. Then the complaints were then passed to the SFC for investigation.

According to a SFC report submitted to the HK government in late 2008, it categorized majority of the complaints about the MBs under three headings[25]

More particularly, the five most common allegations against banks who promoted MBs were that their front line staff:[26]

(a) proactively induced the complainants to turn their matured fixed deposits into investments in Lehman-related products for higher returns and other incentives such as free shopping coupons;

(b) failed to consider the complainants' risk profile and personal circumstances when selling products. This was particularly evident with respect to the retired, elderly, less-educated, less-sophisticated, and risk-averse clients;

(c) did not provide product information by ways of term sheets [terms and conditions of the contract] and prospectuses. Nor did staff explain product features and risks at the point of sale. Some even misrepresented that the products, especially MBs, were risk-free, and analogous to fixed deposits;

(d) only highlighted the well-known reference entities [Lehman Brothers in the US, or in many cases customers where told is a very reputable US bank] of MBs, emphasizing that the risk of MBs was only tied to the credit risk of these reference entities without mentioning the role of and the risk associated with Lehman Holdings; and;

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[25] Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 2 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

[26] Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 35 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

(e) That banks did not respond to complainants' enquiries and complaints after the collapse of Lehman Brothers.

Also, in a legislative context, it is commendable to note that the HK government has instilled further effort to enhance the power of its financial services regulations. The government's attempt includes a report released by the HKMA in early 2009 stating that the regulators [SFC and HKMA], could instigate disciplinary actions against the banks and their staffs for serious breach of banking licence requirements. However, on the flip side, they do not have the power to order the institutions to pay compensation to the investor.[27] The relative inability of Hong Kong regulators to prosecute banks in the MBs saga remained the major cause of the huge public outcries.

Following ten months of street protests, investigations by SFC and HKMA, and committee hearings where senior banks officials testified before the Hong Kong Legislative Council, and negotiations by the SFC on behalf of investors, on July 22, 2009, the Hong Kong banks in a rare and unprecedented move agreed to contribute more than HKD$6 billion to buy back Lehman Brothers' MBs.[28] In the negotiated settlement the Hong Kong banks agreed to pay a price equivalent to 60 percent of the principal of the original investment for investors below the age of 65, and 70 percent for those aged 65 or above. In addition, investors could retain any payments already received. In addition, the banks also agreed that once they have recovered underlying collateral, each of them would make further payments to investors below the age of 65, initially up to 10 percent of the principal of the MBs. And if recoveries exceed 70 percent, the banks will pay the entire excess amount to those who have accepted the offer, which could take some of the settlements to 100 percent. Finally, a requirement of the settlement is that the Hong Kong banks need to inform their customers about the offer in an expeditious manner and deposit the funds in the customers' accounts within 30 days of the offer being accepted. However, professional investors, including

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[27] Hong Kong Monetary Authority, 'Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured products Connected to Lehman Group Companies', 42 <http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf> at 21st September 2009.

[28] http://www.thestandard.com.hk/news_detail.asp?pp_cat=30&art_id=85271&sid=24667606&con_type=1

non-individual and experienced investors, are not covered by this settlement.[29] Although the issue of professional investors remains unsettled, at least the small personal investors look set to recover the majority of their original investments.[30]

The chief executive of the SFC has indicated that the settlements will, '[p]rovide substantial benefits for the vast majority of customers holding minibonds that would not otherwise be received by them', and described the deal as a 'good compromise'.[31] The secretary for Financial Services and the Treasury, Ceajer Chan Ka-keung has added that, '[t]hose accepting the offers will be relieved of the delay and uncertainty in going through the liquidation processes.'[32]

According to the Bank of China (Hong Kong), one month after the settlement was announced, it had received replies from more than 60 percent of MB investors, with almost all accepting the offer of reimbursement of 60 to 70 percent of their original investment.[33]

Whilst this has provided relief for some of the aggrieved MB investors, it does not address the important issue of legal recourse. Or address the issue of whether the prevailing laws are adequate in dealing with the nature of the potential claims.

5. Possible Legal Recourse for MB investors

This article argues that there are potentially three avenues of legal actions that an aggrieved investor in Hong Kong can pursue to recover damages from the bank or financial institution for misleading and deceptive conducts in selling of MBs. These include:

(i) by the contravention of prospectus provisions under Companies Ordinance;

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29 NG, J. (2009). "Banks to Buy Back Lehman Minibonds, the Wall Street Journal," from http://online.wsj.com/article/SB124825602525271653.html.

30 Wang, J. G. (2009). Lehman Minibond Scandle and Its Lessons for the Mainland. China Daily. Beijing: 2.

31 http://stock.cnnb.com.cn/content/channel/tglj/c161/2009/0723/693200340.shtml

32 Wang, J. G. (2009). Lehman Minibond Scandle and Its Lessons for the Mainland. China Daily. Beijing: 2.

33 http://www.thestandard.com.hk/news_detail.asp?we_cat=11&art_id=87034&sid=25173514&con_type=1&d_str=20090828&fc=8

(ii) by misrepresentation under general law and the Misrepresentation Ordinance; and

(iii) by unconscionable conduct under the Unconscionable Contracts Ordinance

All three avenues of legal recourse are attempted below.

(i) Prospectuses

As discussed, MBs were credit-linked financial products. As such, they were a special type of security and in common with securities generally, the issuer maybe under legal obligation to make appropriate disclosure. In accordance with section 2 of the *Companies Ordinance* (CO) disclosure is made by way of a prospectus. The latter is described in section 2 as a document that contains information relating to shares or debentures offered to the public. The disclosure requirements for prospectuses are set out in section 38, CO. Exceptions from prospectus[34] in connection with an offer as prescribed in Part 1 of the Seventeenth Schedule can be excluded from the prospectus requirement by virtue of section 38A CO.[35] Furthermore, there are exclusions of offers that do not fall within the definition of prospectus. As such would be treated as exemptions. They can be found under Part 3 of the Eighteenth Schedule in CO. [36]

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[34] Definition of Prospectus- section 2 CO- means any prospectus, notice, circular, brochure, advertisement, or other document offering shares or debentures of a company.

[35] There are 12 types of offers which are exempted from issuing a prospectus: [35]

(i) An offer to professional investors;[35]
(ii) An offer to less than 50 people;
(iii) An offer in which the total consideration payable for the shares and debentures do not exceed HK$5m;
(iv) An offer of which the minimum consideration payable for the shares or debentures is not less than HK$5m;
(v) An offer in connection with an invitation to enter into an underwriting agreement;
(vi) An offer in connection with a takeover or merger or a share repurchase in compliance with the relevant codes;[35]
(vii) An offer of shares in as bonus shares or dividend shares to current shareholders;
(viii) An offer of shares or debentures to a current or former director, employee, officer, consultant and their spouses and dependents or trustees of any of the above persons;
(ix) An offer of shares of a charitable institution;
(x) An offer of shares to members of a club or association;
(xi) An exchange of shares or debentures of the same company not resulting in increase of capital; and
(xii) An offer in connection with a authorised collective investment scheme with authorised invitation and advertisements by the SFO.

[36] Examples of these exemptions in Part 3 of the Eighteenth Schedule in CO include, offers are aimed at professional investors; offers made to fewer than 50 persons; offers where the amount raised does not exceed HKD$5 million and is accompanied by a statement of warning; or offers where the minimum denomination or consideration is not less than HKD$500,000.

The guiding principle to the contents of a prospectus is to "allow investors to make an informed assessment of the activities of the issuer, its assets and liabilities, its financial position, its management and prospects, its profits and losses and the rights of the shares it offers"[37]. Therefore the law imposes civil liability under section 40 of CO[38] for untrue statements, which includes a material omission from the prospectus.[39] This provision makes a number of persons liable for untrue statements,[40] these include all directors and promoters of the company, as well as persons are authorised the issue of the prospectus.[41]

Whilst the law is clear about liability of 'untrue statements' in prospectus, it did not make clear distinction between fact and opinion, which is an essential element to define the nature of the statements provided. Moreover, economic analysis in prospectus are based on many assumptions about the rate of returns from the investments, it would be difficult to prove on balance of probabilities the projections are unrealistic or half truths and is thus untrue unless the law makes clear the truthfulness of the statement must be based on reasonable premises and not over inflated expectations.[42]

Since section 40 of the CO remains untested as there are no cases on untrue statements in prospectus,[43] it would be difficult to give an opinion if the investors of MBs could successful mount a challenge against the banks and financial institution

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37 Paul Kwan p439

38 Note that section 40 and 40A, CO contains both civil and criminal penalties as well as defences for misstatements in prospectus. For the purpose of this article, only civil liabilities will be discussed.

39 Section 41A CO

40 See section 40(7) CO

41 Paul Kwan p 456. Defences are available under section 40(2) and (3) of CO to a director and expert respectively, who authorises the issue of the prospectus containing an untrue statement, if he-

(a) Withdraws his consent before delivery of the prospectus for registration;
(b) Gives reasonable notice to withdraw his consent between registration of the prospectus and any allotment under it; or
(c) That he is competent and believes on reasonable grounds that the statement is true.

42 Frank Clarke and Graeme Dean, *Indecent Disclosure: Gilding the Corporate Lily* (2007) 14-32

43 However, note that in the recent administrative appeal case of *Chiang Lily v Secretary for Justice* [2009] HKCU 230, section 40 of CO was considered in relation to a legal for misleading statements in a prospectus. It is anticipated that a trial on this issue will be hear before the High Court later this year.

even they have found questionable statements in the prospectus. Alternatively, even if the MB investors could commence legal action under general law, it might not be a viable option because plaintiffs have to prove that they have relied on the representation and statements in the prospectus to purchase the MBs,[44] not to mention the difficulties as discussed in the above, associated with proving the untrueness of statements.

Another avenue for MB investors would be making a claim under disclosure of false or misleading information inducing transactions under section 277 of *Securities and Futures Ordinance* (SFO), this falls under market misconduct. The meaning of this provision also cover parties who engage in, or assisting, counselling or procuring another person to engage in, any conduct of disclosure of false or misleading information inducing transactions within the meaning of section 277.[45] But to prove this, the person or the body corporate (banks) selling the MB must know, or is reckless / negligent as to whether the information is false or misleading as to the material fact, or through omission of a material fact.[46] The burden of proof is substantial. Also the seller of MB might not be held accountable for disclosing false or misleading information if they were merely reproducing information provided by third party.[47]

While this paper is not suggesting that disclosure is an ineffective regulatory mechanism, we simply making the case that for some types of securities, disclosure through prospectuses might not be well suited for retail investors, due to the fact that

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44 See *Caparo Industries v Dickman* [1990] 2 AC 605,

45 Section 245 SFO

46 Paul Kwan, p 459

47 Section 277 (2) SFO states, *"A person shall not be regarded as having engaged in* market misconduct *by reason of disclosure of false or misleading information inducing transactions if the disclosure has taken place by reason only of the* issue *or reproduction of the information and he establishes that-*

> *(a) the* issue *or reproduction of the information took place in the ordinary course of a business (whether or not carried on by him), the* principal *purpose of which was issuing or reproducing materials provided by others; (b) the contents of the information were not, wholly or partly, devised- (i) where the business was carried on by him, by himself or any officer, employee or agent of his; or (ii) where the business was not carried on by him, by himself; (c) for the purposes of the* issue *or reproduction- (i) where the business was carried on by him, he or any officer, employee or agent of his; or (ii) where the business was not carried on by him, he, did not select, add to, modify or otherwise exercise control over the contents of the information; and (d) at the time of the* issue *or reproduction, he did not know that the information was false or misleading as to a material fact or was false or misleading through the omission of a material fact".*

these investors are laypersons and consequently not familiar with technical financial terms or analysis. The complexity of the information on MBs was one of the most common complaints that the SFC had received from MB investors.[48] Therefore, it is unlikely MB investors could succeed making claims under section 40 of CO or section 277 of SFO if they fail to understand the information provided in the prospectus.

(ii) Misrepresentation

Under general law aggrieved investors could bring actions for misrepresentation, whether the misrepresentation is fraudulent, innocent and/or negligent.[49] To qualify for misrepresentation, the statement of conduct has to be one of fact, not of law. Also, the plaintiff has to rely on the representor's statement or conduct.

Misrepresentation is "an untrue statement of fact made by one party to the other in the course of negotiating a contract that induces the other party to enter into the contract."[50] It is "representation which does not accord with the true facts (past or present)."[51] So for the MB investor, he/she is required to proof the following elements:

- False factual statement
- Reliance by one party
- Materiality

The plaintiff must proof that the statement is in fact untrue. The untrue nature of a statement is distinguished from future promises, mere pufferies, statements of intention and opinion. However, (mis)representation can be implied silently without words by conduct, such as a nod or a wink, a shake of the head, smile intended to induce. [52] Next, the reliance by the representee (MB investor) must be intended by the representor (the bank) when the (mis) representation is made. Reliance often refers to

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48 Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 2 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

49 Lawrence Ma, *Equity and Trust Law in Hong Kong* (2006) 157.

50 OUP, *Oxford Dictionary of Law* (2001) at p.317

51 Carter, Penden & Tolhurst- Contracts Law in Australia 5th ed. P. 369

52 See *Walters v Morgan* (1861) 3 De GF & J 718 at 724.

the vulnerability of the representee, that the representor holds more knowledge in a contractual situation. To satisfy this element of reliance, the representee must have been induced into signing the contract, and subsequently suffered a loss or damage. This is a question of fact which the "representation must be shown to have reached and misled the mind of the person taking the decision to contract"[53]. Besides, non-disclosure of non-material facts does not constitute misrepresentation[54]. Therefore, the statement or conduct of the facts relied upon must be of significance, that is of materiality.[55]

Misrepresentations Ordinance (MO) attempts to broaden the scope of liability in a non-fraudulent situation and the right to award damages in lieu of rescission.[56] It is not possible to contract out of the entire Ordinance.[57] Then again, section 2 only covers the 'terms of the contract'[58].

Section 3 of the MO implies conduct of misrepresentation limited to negotiations before the signing of contract. In the case of *Aktieselskabet*, the court affirmed that "when a representation had been made but with some essential qualification or modification omitted, without the inclusion of which the original statement became untrue, the maker of the representation was guilty of misrepresentation by omission".[59] And added that "…if this occurs during negotiation, the party with knowledge is required to speak and correct the mistaken belief of the other party as created by earlier statements". [60]

In *Long Year Development Ltd v Tse Fuk Man Norman*,[61] Deputy Judge Li [Court of First Instance] held that third parties have to prove they had reasonable grounds to

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53 Carter, Penden & Tolhurst- Contracts Law in Australia 5th ed. P.376; Also see Macleay v Tait [1906] AC 24; A-G New South Wales v Peters (124) 23 CLR 146.

54 See Smith v Hughes (1871) LR 6 QB 597; W Scott Fell & Co v Lloyd (1906) 4 CLR 572; United Dominions Corp Ltd v Brian Pty Ltd (1985) 157 CLR1 at 5-6.

55 Saunders v Queensland Insurance [1931] HCA 42

56 Section 2, Misrepresentation Ordinance.

57 Lawrence Ma, *Equity and Trust Law in Hong Kong* (2006) 158.

58 Misrepresentation Ordinance

59 *Aktieselskabet Dansk Skibsfinansiering v Wheelock Marden & Co Ltd* [1998] 3 HKC 153 at pp164 E-F.

60 Ibid at pp 164F-G.

61 *Long Year Development Ltd v Tse Fuk Man Norman* [1991] HKCFI 186; HCA003959/1989, Paras. 53 and 54.

believe and did believe up to the time the contract was made that the facts represented were true, casual observation on one occasion on a matter which could easily be ascertained and verified from the title documents does not constitute a reasonable ground, the defendant was still liable under section 3 (1) of MO.[62]

Extending by analogy to the aggrieved MB investors in Hong Kong, the banks and intermediaries have an obligation to disclose material facts of associated high risks and potential losses suffered as it substantially affects the purchase decision of the investors. SFC also noted in a report to the HK government that they received 87 complaints about misrepresentation by bank staff to MB investors.[63] Much of which could be categorised into two main issues: 1. Distributors of MB misrepresented MB as low risk products and, 2. Distributors did not disclosure the role of Lehman Brothers.[64] The aggrieved MB investors could pursue legal action under misrepresentation.

Then again, it is difficult to take a view at this stage, the possibility of success for MB investors to pursue the banks for misrepresentation from media reports and complaints received by SFC. It could be that the investors did not bother to study the facts before purchasing the MBs, or that their decisions were motivated by the conduct of bank staffs rather than the facts given the prospectus. As a defence, the bank staffs could claim that when the statement was made to the client, he / she believed on reasonable grounds that the statement was true, or that he / she relied on the statements from MB provider and had no reason to doubt it was not true. On the issue of whether the MB investors would not have bought an investment product if they had known it was by the Lehman Brothers remains speculative.

In a nutshell, misrepresentation is an untrue statement. This is a question of fact, not a casual observation. It covers omission during negotiation and the need to clarify any mistaken or erroneous beliefs with respect to the contract. MO might have broadened

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62 [1991] HKCFI 186; HCA003959/1989

63 Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' 36 <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

64 Ibid.

the scope and remedies of general law obligations, but the statutory obligations did not take into account special disability or vulnerability of plaintiffs. Nor does it address the issue of conduct leading the plaintiff to erroneous interpretation of facts. The narrowness of the ordinance needs to capture misleading or deceptive conduct.

(iii) Unconscionable Contracts

The Unconscionable Contracts Ordinance (UCO) deal with special disability or vulnerabilities not covered under MO. UCO provides statutory recourse dealing with the contracts of sale of goods or provisions of services to consumers. Section 5 of the UCO empowers the court to give relief in such contracts as it find unconscionable, provided that the contract was entered into prior to 1994. In exercising its powers, the court may refuse to enforce the contract; enforce the remainder of the contract after omitting the unconscionable part(s);and /or revise or alter the application of any unconscionable parts of the contracts.

Unconscionability refers to a number of things including, "unfairness, injustice, and unreasonable or excessive conduct against the conscience as recognised by equity".[65] In determining unconscionability the court would consider the following:[66]

(a) The relative strengths of the bargaining positions of both parties;
(b) Whether unreasonable provisions in the nature of penalising the consumer exist;
(c) Whether the document containing terms of supply or service is comprehensive;
(d) Whether any pressure was exerted on or any unfair tactics were used against the consumer; and
(e) Whether the amount charged for the supply of goods or services exceeds the usual or market rate at that time.

The concept of unconscionability is subjective in the eyes of the court with the notion of "fairness" and "justice". The equity principle of unconscionability co-exists with other contractual obligations. As Finn has pointed out, the gist of the conscience of

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65 Lawrence Ma, *Equity and Trust Law in Hong Kong* (2006) 148.
66 Section 6 of the UCO, and Lawrence Ma, *Equity and Trust Law in Hong Kong* (2006) 153.

equity has two central concerns - the first is the protection of the vulnerable and the second is the protection of people's reasonable expectations.[67]

In a tribunal appeal case of *Shum Kit Ching v Caesar Beauty Centre Ltd* [68], the appellant, Shum had entered into a beauty therapy VIP membership worth $48,060 and attempted to withdraw from performance of the contract on the following day but failed. The appeal was brought subsequent to the first instance decision to dismiss the complaint based on misdirection of law. Shum's counsel submitted that her weakness was easily persuaded into spending money without understanding of the contract, but the Recorder Chan held that this in itself is insufficient to constitute to render the contract unconscionable. And he added that,

> [U]nconscionable as meaning 'wholly unreasonable, not guided or restrained by conscience'. Certainly there is an element of lack of conscience before one can say that that thing is unconscionable and it is difficult to see how a person's conscience could be affected by things that he does not know. Accordingly in the context of s 5 of the Ordinance [UCO], it is difficult to envisage a situation where the party against whom relief is sought not knowing the points of weakness of the other party and not exploiting the points of weakness of the other party to induce the other party to enter into the contract, could nevertheless produce a result that the contract entered into be properly described as unconscionable.[69]

Thus legal action on the grounds of unconscionability requires more than mere weakness or that the plaintiff was easily persuaded to sign a contract. If the consumer alleges unconscionability he / she bear the onus of proof.[70] There are three elements required:[71] 1. The consumer was suffering from some kind of disability or disadvantage; 2. The transaction was unfair and oppressive and; 3. The defendant exploited the weaknesses of the plaintiff. Furthermore, in order to seek relief under

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67 Finn, P *"Unconscionable Conduct"* (1994) 8 Journal of Contract Law 37.
68 [2003] 3 HKC 235
69 Ibid at para 13.
70 Lawrence Ma, *Equity and Trust Law in Hong Kong* (2006) 153.
71 Ibid, 148.

unconscionability, the plaintiff must also proof that there is no improper acts on their behalf. [72]

In a rejoinder to the MB investors in Hong Kong, for them to sue the banks under UCO, they have to prove the above elements. Whilst the media had reported that there were many vulnerable elderly who were duped to invest in MBs, out of the three elements needed to sustain this legal action, proving the second and third elements might not be as straightforward as one might think. Besides, in *Shum* case in the above, it was held mere weakness in itself did not constitute unconscionable.

Thus far the discussions about the three possible avenues of legal recourse for aggrieved MB investors have demonstrated some difficulties and hurdles that plaintiffs have to overcome in order to sustain legal actions against the banks and financial institutions in seeking compensation. This could explain why the MB investors had to resort to street protest rather than legal action.

To date there has only been one reported court action brought by investors of the MBs. It commenced in the Hong Kong district court in late 2009. According to the Hong Kong Standard[73] the current case involves a nurse, Chan Mei-ying who is suing Citibank on the grounds that it misrepresented the nature and risk of MBs. In the writ filed with the District Court, Chan alleged that bank staff told her the product was very similar to a fixed deposit, with a yearly interest of about 4 percent.[74] In the wake of the Lehman Brothers collapse, Chan claims to have lost her investment of HKD$500,000.

The Hong Kong Standard also reported that in 2008 Citibank completed a risk profile on Chan's behalf. She was classified as an "active and experienced investor" with "aggressive" investment objectives and high risk tolerance. But Chan alleged that one

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72 Meyers v Casey (1913) 17 CLR 90 at 124 per Issacs J.

73 For full article see Patsy Moy, 'Lehman investor to get her day in court' (The Hong Kong Standard, 25th September 2009) <http://www.thestandard.com.hk/news_detail.asp?pp_cat=30&art_id=88391&sid=25487561&con_type=1#> at 25 September 2009.

74 Patsy Moy, 'Lehman investor to get her day in court' (The Hong Kong Standard, 25th September 2009) <http://www.thestandard.com.hk/news_detail.asp?pp_cat=30&art_id=88391&sid=25487561&con_type=1#> at 25 September 2009.

of the Citibank relationship managers who dealt with her account listed her investment preferences as "low" to "moderate" in risk levels. In addition, Chan claimed that she considered Lau and Yee another Citibank relationship manager, to be her investment advisers. Indeed, from time to time both had recommended investments that Chan acquired. In January 2008, Lau told Chan that the term on her fixed deposit of HKD$400,000 had expired and invited her to discuss her investment plan. Chan said she met Lau and persuaded her to subscribe to a Lehman equity-linked note [MB]. Chan invested her entire savings of HK$500,000 in the MB. Chan further claimed that she was not told the nature of the risk involved with the product. Rather, she was advised that she would lose "a good opportunity" if she did not subscribe before the deadline. On September 15 2008, Chan said she was shocked to discover the huge loss when Lau contacted her to advise that the note was negative in value owing to the collapse of Lehman Brothers. Chan is suing Citibank of a breach of duty and is claiming damages, interest and costs.[75]

Until the case has been decided, it would be unwise to accuse either party of any wrong doing. Nevertheless from the above allegations, it is easy to appreciate why legal actions could be difficult – the context and the actual words used to represent of the contract is open to challenge. Besides, there is no mention of whether or not the plaintiff has a copy of the prospectus or that she had read it.

Rather than criticising the scope and robustness of each ordinance, the answer is perhaps to reform these laws in a integrative and coherent them manner, to broaden the scope of the regulation, as well as raising the standards as to reducing chances of repeating MB incident. Even if there might be a high cost in complying with a higher standard, there will be a better dividend for both the financial sector as a whole, not to mention that the investors would be more inspired by greater confidence in both the financial product offered and services provided. This is a matter of legal reforms which the government has to address.

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[75] Patsy Moy, 'Lehman investor to get her day in court' (The Hong Kong Standard, 25th September 2009) <http://www.thestandard.com.hk/news_detail.asp?pp_cat=30&art_id=88391&sid=25487561&con_type=1#> at 25 September 2009.

6 Proposals by the Hong Kong government

Taken as a whole, the MB crisis indicates that the regulating financial products and service in Hong Kong have two obvious gaps: first, the way in which information is disclosed to investors; and second, the provisions of in CO, MO and UCO lacks 'depth' and 'breathe'.[76]

In September 2009, the SFC produced a considerable large publication titled – 'Consultation Paper on Proposals to Enhance Protection of the Investing Public'. In the executive summary of this consultation paper states:

> [T]he stress put on our financial infrastructure and in particular the direct impact of the collapse of Lehmans, one of the world's largest investment banks, has served to highlight significant concerns about how certain investment products have been sold to members of the public in Hong Kong…[T]he collapse of Lehmans resulted in the early termination of a number of products it had arranged and which had been sold to the Hong Kong public, resulting in significant losses for investors. Over 20,000 complaints were received from investors in Lehman products nearly all of which contained allegations of mis-selling…[T]his paper proposes enhancements to the regulation of the sale of retail products in response to issues highlighted by the early termination of Lehman products.[77]

And added that,

> While the resilience that our financial infrastructure has shown during the financial crisis has attracted positive comments, the Minibonds incident has exposed issues in connection with the sale of investment products and has negatively impacted on the reputation of our market both locally and

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[76] See Hong Kong Monetary Authority, 'Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured products Connected to Lehman Group Companies', <http://www.info.gov.hk/hkma/eng/new/lehman/lehman_report.pdf> at 21st September 2009, and Securities and Futures Commission, 'Issues raised by the Lehmans Minibonds crisis: Report to the Financial Secretary, December 2008' <http://www.sfc.hk/sfc/doc/EN/general/general/lehman/Review%20Report/Review%20Report.pdf> at 22nd September 2009.

[77] Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 4 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

> internationally. In order to restore the trust and confidence in our market we believe that the Government, the regulators and the industry need to collectively demonstrate that the lessons of this incident have been learned and that appropriate action has been taken.[78]

Evidently, the SFC recognised the importance of the problem and the urgency for reforms, but they were cautious to use the label "mis-selling" rather than "misrepresentation" which indicates more explicit legal liability. But there was no discussions about amending the MO or UCO.

The main consultation document is 93 pages long with a total of 32 questions posed to the public for feedback. Much of the proposals contained in the document are interconnected. The crux of the proposals is to divide the regulatory recommendations into three key stages: 'pre-sale', 'sale' and 'post-sale'.[79] More importantly, the proposals according to SFC, '[i]s premised on Hong Kong continuing to adopt a largely "disclosure-based approached"…'[80] Therefore in the following this paper shall examine the proposed disclosure related measures, which is also relevant in addressing the key issue of misrepresentation and misleading representation highlighted in the above discussions.[81]

Under key proposals in the code on Unlisted Structured Products, Unit Trust and Mutual Funds and Investment-linked Assurance Scheme, the SFC proposed that the PKFS are to be included with the offering document. And instead of adopting a rigid and prescriptive set of rules, it prefers to lay down the principles of providing

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78 Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 5 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

79 Ibid.

80 Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 8 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

81 Note there is a distinction between misrepresent and mislead. The former refers to an untrue statement of fact, the latter statements that leads people to believe in something untrue, half truths, or gives an impression that is false. See *Australian Competition and Consumer Commission v Henry Kaye and National Investment Institute Pty Ltd* [2004] FCA 1363 and *ACCC v Emerald Ocean Distributors Pty Ltd* [2005] FCA 1703.

guidance on disclosure standards.[82] Amongst the list of items to disclose are the characteristics, nature, and features of the product, as well as the risk of the products.[83] Whilst this is best practice drawn from US, UK and Australia, the implementation of these ideas can be quite challenging. For the reason that some products like MBs is nearly impossible to explain in a short document in layperson terms. The Lehman Brothers MBs prospectus worked out to be close to a hundred pages. More problematical is the explanation of risk in layperson terms, especially when it involves complicated statistical and econometric forecast.

By having a laundry list of disclosure items by itself is not a cure of the ills learnt from the Lehman Brothers MBs crisis in Hong Kong. Often how to put across complex information of financial products and their risk is not as simple as one would presume. This does not however suggest disclosure is ineffective or unworkable. Attention should be given to ensure the information contained in a PKFS is drafted in such a way that layperson and the average investor can comprehend. And it would be a mistake to assume or propose standardisation (which is SFC is also proposing) of offer documents and advertisements is the solution to this multifaceted problem.[84]

What the government consultant paper did not discuss or even contemplate is the issue of whether the prevailing statutes need to be amended. From the previous section, this article has highlighted certain gaps in CO, MO and UCO that needs to be addressed. One possible integrated solution is to amend the law to ensure the PKFS is subjected to an amended MO and UCO so that the contents of that the document would not misrepresent, misled, or deceive investors along the lines of Australian laws.

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82 Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 26, 48 and 56 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

83 Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 27, 48, and 56 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

84 See Securities and Futures Commission, 'Consultation Paper on Proposals to Enhance Protection of the Investing Public; September 2009' 8 <https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=publicinvestorprotection> at 22 January 2010.

For example, a recent newspaper advertisement in Hong Kong uses such catchphrase: "introducing the world's *first crash-tested* [emphasis added] fund" in bold. Does this imply it has a long track record, or it has undergone some kind of econometric testing? Or it is merely a slang used to describe something else? A disclaimer was added on a separate section of this advertisement in fine prints stating, "the product is *relatively new* [emphasis added] and it is not possible to predict its future development and risks". Whilst this statement is meant for potential investors, does the words in bold compared to the fine prints create more confusion or clarity for laypersons?

Australian courts had formed the view that context is important to the characterisation of representation, as well as how the disclaimers and qualifications are being presented. [85] The disproportion between representation and qualifying statements might be considered misleading and deceptive conduct.[86] This paper therefore proposes that Hong Kong could look at Australian as a reference point for reforms. Australia has taken more prescriptive and detailed rules with sections 1041H and 991A(1) in the Corporations Act 2001 (Cth) (CA) and sections 12DA and 12CA(1) of the Australian Securities and Investment Commission Act 2001 (Cth) (ASICA). These statutes widen the concept of misrepresentation under the classification of "misleading and deceptive conduct" and refined the notion of "unconscionability" in the context of financial product and services.[87] In addition, unlike MO, section 1041H of CA and 12CA(1) of ASICA makes no distinction between mere puffs and misleading and deceptive conducts.[88] As for unconscionability, section 12CA(1) of ASICA differs from section 6 of UCO by making clear references to financial service providers. Hence, amendments to the MO to broaden the scope of misrepresentation to include misleading and deceptive conducts along the lines of the Australian

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85 Gail Perason, p. 234

86 Medical Benefits Fund of Australia Ltd v Cassidy [2003] FCAFC 289 per Stone J at 41.

87 It is worthy to note that sections 1041H of CA and 12DA of ASICA were drawn from section 52 of the Australian Trade Practices Act 1974 (Cth) (TPA), and 991A(1) of CA, and 12CA(1) of the ASICA mimicked obligations in sections 51AA, 51AB, and 51AC of the TPA. See Gail Pearson, *Financial Services Law and Compliance in Australia* (2009) 217. Therefore the meanings of these provisions are borrowed from TPA. For example, the court considers the ordinary meaning of the words "mislead" and "deceive" shares the common element of "lead to error". Further, the section also covers the concept of "likely to mislead or deceive". The words "likely to" add value to the section in the sense that it is unnecessary to prove that the conduct in question actually deceived or misled anyone. See Gibbs CJ in *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149CLR 191; 56 ALJR 715; 42 ALR 1; ATPR 40-307 at 198(CLR).

88 Therefore the meanings of these provisions are borrowed from TPA

provisions could broaden the narrow confines of misrepresentation. Furthermore, making the UCO applicable to financial services could better account for certain vulnerabilities that are specific to retail investors.

7 Conclusions

The article has attempted to analyse the aftermath of the Lehman Brothers MBs and its impact on its investors. Despite the fact that the tragic losses of tens of thousands of investors and the public outrage occurred in Hong Kong, the banks and financial institutions were unpunished by the law. As a matter of fact, this had resulted in a wider impact on the Hong Kong international financial hub. Clearly, urgent regulatory reforms are needed as an attempt to rebuild the public's confidence in Hong Kong's financial sector, as well as the island's international reputation.

This is however not as straightforward as merely introducing new laws or codes. Financial innovation can be both a blessing and a curse, because without it, there might be liquidity problems which would impede economic growth, as well as removes the availability of alternative investment products offered to individuals and corporations. This is unfortunately never an easy task. Even an attempt in this paper to explain what MBs are had been plagued with problems as they are complicated financial innovation not easily conveyed in simple terms.

Hong Kong alleged to be one of the free economies in the world. The government has a long tradition of the positive non-intervention culture in regulating its economic matters. Thus the government did not impose obsessive regulations on the local banks and financial institutions. This requires a consumer or a retail investor to take a "buyer beware" approach in their investment decision-making. Naturally, this also lead to the fact that Hong Kong does not have a systemic legal environment which can safeguard the rights of consumers at large.

Even if the reports in the media regarding the allegations of misrepresentation were true, as noted the narrow construction and specificity of the legislations in Hong Kong meant that the chances of winning the court-case would be like 'rolling of the dices'.

Whilst there is some successes on the part of the efforts of the SFC and other HK government department to help MB investors to negotiate with the local banks and financial institutions, the outcomes were that those institutions refunded about 60 to 70 percent of the original investments. Nevertheless, this does not signify any legal consequence that the wrongdoers would suffer, neither this would establish any precedents for the future similar situations.

The reason for the need for governmental intervention in relieving investors is perhaps due to the difficulties involve in mounting legal action against the banks and financial institutions. Apart from the high cost of litigation, as noted the provisions in CO, MO, and UCO are either too narrowly constructed or is difficult for the plaintiff to make a case.

The SFC had put forward a set of proposals for public consultation to date. In which the underlying rationale was "disclosure based". Whilst this paper does not reject the merits of a disclosure based approach to regulate financial products, it cautions against the over reliance of such measures without addressing the finer points in fixing the problem – as an old saying goes: "the devil is in the details" in particular with regards to misleading and deceptive conduct and unconscionable conduct.

In conclusion, this paper acknowledges that regulating the sale of financial products requires a balanced approach. On the one hand there needs to be flexibility in how each institution or financial investment provider disclosure information specific to their products; and on the other hand, there needs to be a clear minimum standard backed by statutes to serve as default legal rules. Therefore, the law should be amended to ensure the contents of the PKFS will not misrepresent, mislead or deceive potential investors, liken the Australian provisions suggested in the above. This is, in the authors' view, fundamental to the success of the SFC proposals.